The IMF's *World Economic Outlook: Advancing Structural Reforms, April 2004*

BACKGROUND AND INTRODUCTION: This EG technical briefing reviews the April 2004 *World Economic Outlook (WEO)*, the IMF's latest semi-annual report on the current state of the world economy. The publication presents estimates and one to two year projections of economic growth rates by region, world wide and for various individual countries. The estimates and projections, presented in the *WEO*'s first chapter, are by IMF staff and are updated every six months. The outlook projected this time is very bright -the world economy is described as the 'rosiest' in a decade: global economic growth is projected to be 4.6 percent this year and 4.4 percent in 2005. This is about a half percentage point above what IMF staff had estimated growth to be in last September's *WEO*. Lest one feels too good about the rosy outlook, one is reminded that the outlook is subject to a number of things that could go wrong.

The *WEO* also contains chapters by IMF staff on various economic growth related issues. This issue focuses heavily on countries' need to carry out structural reforms to increase economic growth rates and guard against adverse, growth unfriendly developments. Accordingly it has a chapter on the experience of industrial countries in doing structural reforms in various sectors. The issue closes with a chapter on the effects of credit booms and busts, and how emerging markets countries can avoid them, which will be interest to readers whose countries are in the emerging markets country group or are aspiring to achieve that status.

The 2004 World Outlook for Economic Growth – Unusually Good! Highlights from the WEO's Chapter I: The 2004 world growth outlook is very positive, with the U.S. economy surging in recovery from its growth slowdown of a while back, and now projected to grow 4.6 percent in 2004, seen as providing a so far non-inflationary growth stimulus to the rest of the world. In Asia, China and India are the countries likely to have the highest GDP growth rates in 2004, 8.5 and 6.8 percent respectively. Japan's GDP is projected to increase by 3.4 percent in 2004. In Sub-Saharan Africa,[1] GDP growth is expected to increase sharply in 2004 – all the way to 4.2 percent compared to last year's actual 3.5 percent increase (which by the way was higher by 0.4 points than had been projected in last September's *WEO*.[2] The higher performance of this region is ascribed to improved macroeconomic fundamentals, higher commodity prices, better weather conditions, and an oil production surge in Nigeria.[3] In the Middle East, projected GDP growth is 4.1 percent, slightly lower than had been foreseen six months ago.[4] Economic challenges, it is said, limit Central and Eastern Europe economies to a projected average growth rate of 4.5 percent in 2004 - the same as last year's actual rate.

But Not Equally Good Everywhere, of Course: Currently unfavorable economic growth prospects impede economies from coping with future adverse developments. Economies worldwide are seen as vulnerable to 'geographical risks,' including terrorist attacks in parts of the world, tensions in the Middle East, fluctuating oil prices, and financial market destabilization. To do well on a sustained basis, economies need to be able to absorb such shocks and bounce back from them. To become more resilient to adverse events, economies worldwide, says the *WEO*, need to undertake timely and opportune reforms while times are good, and before the memory of hard times from the previous downturn of the economy has faded.

Two Factors Impacting the Global Situation: The report's second chapter deals with two major factors it sees impacting things globally - the U.S. fiscal deficit and that of the emergence of China as a major exporter of a wide range of commodities on the world scene. Predicting the current US recovery will have to be reined in by U.S. monetary authorities, it predicts that other factors will have to drive global expansion if it is to continue.

China's dramatically increasing role and place in the world economy, the report notes, can be a win-win

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situation world wide, with all countries achieving maximum benefit from China's continuing rapid integration into the world economy. But for this to happen, countries worldwide including developing countries will have to increase the flexibility of their economies through structural reforms, and must increase, not reduce, the degree of their own integration into the global economy.[5]

Doing Structural Reforms to Accelerate Growth: In its third chapter the report examines and analyzes the experience of the industrial countries in initiating and carrying out structural reforms in their trade and financial sectors, in fiscal policy, price and labor market flexibility, and regulation of infrastructure industries. Taking a political economy perspective, it describes and explains the differing degrees to which industrial countries have implemented such structural reforms. It quantifies the benefits, costs and net benefits of undertaking the various kinds of structural reforms. The analysis is limited to industrialized countries, due in part to data limitations, of dealing with a broader array of countries. But the analysis of this chapter is obviously highly relevant to most developing and transitional economies and we would recommend that readers take a look at it.

Credit Booms and Busts in Emerging Markets (EMs): The report's final chapter focuses on credit booms in emerging markets, defined as "unsustainably excessive cyclical credit expansions" which eventually collapse of their own accord. It distinguishes such "credit booms" from other kinds of episodes of rapid and sustainable credit expansion which do not end in bust. Looking at EM country experience of credit booms and other kinds of credit expansion episodes between 1970 and 2002, the chapter argues that during the cycle, "financial accelerators" operate so that macroeconomic shocks to asset prices get amplified through balance sheet effects. The result can be a credit "boom and bust episode". Evidence suggests that credit booms pose significant risks for emerging market countries, because they are typically followed by sharp economic downturns and financial crises. The report identifies some key characteristics of credit booms in emerging markets.[6]

HOW TO ACCESS THIS REPORT: The full document of the *World Economic Outlook: Advancing Structural Reforms,* April 2004 – as well as previous publications in the series, can be assessed at: http://www.imf.org/external/pubs/ft/weo/2004/01/index.htm

ENDNOTES:

[1] Including Nigeria but not South Africa, which is classified as an emerging market economy.

[2] The WEO's authors note that the GDP growth rate projections for Sub-Saharan Africa have been especially prone to error, with rates of growth projections tending to overestimate actual rates achieved.

[3] While the 2003 actual growth rate of Sub-Saharan GDP is higher than was projected in the September 2003 *WEO*, the current issue revises the growth rate for 2004 downward, by 0.6 points, from 4.8 percent to 4.2 percent.

[4] This slight adjustment is mainly due to recognition that growth in oil production is likely to be slower than previously thought.

[5] Most countries doing this, the chapter argues, can expect to be able to benefit on balance from China's rapid integration into the world economy, though the benefit for them in terms of the increase in their real GDP is likely to be small in percentage terms. Any countries that might adversely affected, the *WEO* suggests, could be helped significantly by the removal by advanced countries of remaining constraints on world trade, for instance in agricultural products.

[6] Credit booms in EMs are found to be: 1) much less common than simple episodes of rapid credit growth; 2) synchronized in time across countries, suggesting that common influences on capital flows and financial liberalization – contagion - may have played an important role; 3) somewhat asymmetric; 4) tending with almost 70 percent probability to coincide with either a consumption or investment boom, but less likely to coincide with an output boom, and (6) often associated with banking and currency crises.